The newsletter for insurance brokers and MGAs

Issue one: Spring 2024

PKF

Broking Business

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Welcome to our latest issue of Broking Business...

Following its recent reviews, the FCA has found that wind-down plans fell short of the minimum standards they expected and confirmed they would continue engaging with the market in 2024. The FCA also continues to look at CASS 5 rules in more detail, although firms' compliance with the CASS 5 client rules is improving. We explored the shortcomings in wind-down planning and examined CASS 5 hot topics at our London and Leeds Broking Breakfast events. If you weren't able to join us, you can still listen to the on-demand version here.

How insurance intermediaries treat client money balances held for legacy insurance and reinsurance business has always been a confusing issue. This issue has possibly been aggravated by recent FCA views, particularly with regards to CP12/20 and CP23/12. Our guest author, Timothy Goodger, Partner at City law firm Elborne Mitchell, considers why credit write-backs are under such scrutiny and if they are in-fact a breach of trust law.

Providing share incentives to firm employees is a great way to encourage staff retention and business development. But beware. Whatever the circumstances of your wanting to provide staff perks, there are tax issues to consider. Tom Golding, Corporate Tax Partner, looks at the common ways to provide share incentives and how they trigger tax.

As insurance brokers are gatekeepers of a wealth of personal data, navigating the complex landscape of privacy regulations must be undertaken with the utmost due diligence. A robust data protection policy is not just an ICO regulated mandate, but also essential for consumer trust and integrity. Phil Broadbery, Technology Partner, examines the benefits of the controls-based approach to data protection.

As always, please contact any of the team to discuss how we can support your business and let us know your thoughts on future topics.

Paul Goldwin
Head of Insurance Intermediaries

+44 (0)20 7516 2251
pgoldwin@pkf-l.com

Credit write-backs – a breach of trust law?

Timothy Goodger, Partner at City law firm Elborne Mitchell LLP, considers why CWBs are under so much scrutiny.

The way insurance and reinsurance intermediaries treat client money balances held for legacy insurance and reinsurance business remains a thorny and confusing issue.

This may well have been aggravated by the different views expressed by the FSA and the FCA over the years. They include the FSA's comments in its 2008 paper entitled **Credit write-backs: an articulation of the FSA's position** and subsequently in CP12/20, in which the FSA suggested draft CASS 5A rules to address aged balances. The latter considered payment of unreconciled balances to a charity.

Then, in 2023, the FCA proposed an expansion of the Dormant Assets Scheme as set out in CP23/12 with payment of balances to an authorised reclaim fund (ARF). More recently, it's suggested the mechanism of so-called credit write-backs (CWBs), by which an intermediary writes back balances from client money trust accounts into its profit and loss account, is a breach of trust.

This step-change in approach has led to concern among intermediaries about how they can deal with unclaimed, unmatched and unreconciled balances. And particularly so since various intermediaries have aligned their processes with the 2008 **Articulation** and/or CP12/20. This alignment has resulted in intermediaries making CWBs, but equally making adequate provision in their accounts for potential claims to those balances.

The issue is further complicated by CASS 5 having neither a provision that prohibits CWBs nor a definition of them. That said, the FCA has sought to describe what they are, albeit in consultations.

Dealing with insurance transaction monies

The way an intermediary deals with insurance transaction monies, and specifically client money, is determined by the capacity in which it has received them and the basis on which it is obliged to hold them. That depends on the specific terms of business an intermediary has with its various counterparties and whether monies are received either on a non-risk transfer basis as agent for a policyholder, or on a risk transfer basis as agent for a re/insurer.

When an intermediary holds money pursuant to a statutory trust or a non-statutory trust (NST) per either CASS 5.3 or CASS 5.4 respectively, it does so as a trustee. This also applies if the money is held under an express trust account for re/insurers, such as a designated insurer trust account outside the CASS regime.

A NST, and potentially an express trust, is constituted by a deed and the intermediary is limited by the terms of that deed at the time it was executed. What's more, when an intermediary is a trustee it has a fiduciary relationship with each beneficiary and must comply with additional duties and obligations.

But where a re/insurer has granted risk transfer to an intermediary and has stipulated the intermediary holds that money in an insurance broking account (outside CASS), this creates a debtor/creditor relationship between the intermediary and the re/insurer, rather than a trust. This means different obligations and considerations apply.

In any case, a UK intermediary, as a fiduciary, usually has an ongoing duty to account for money it receives from its clients and/or as agent for a counterparty.

Always a breach of trust?

It would be simplistic to say that any CWB is a breach of trust. It suggests any balances which cannot be reconciled or repatriated to a counterparty cannot be written to the intermediary's profit and loss account in any circumstances. Clearly, writing back a balance without review or investigation might be open to criticism. But the approach to unmatched and unreconciled funds and any CWB ought to be considered in the wider context of the business written and the make-up of the balance. Also relevant is the relationship between the intermediary and its counterparties.

The vagaries of intermediary accounting mean that a ledger may well have unreconciled or unmatched balances due to the intermediary. These may be a result of netting off commission and fees, set-off between premiums and claims either by a policyholder or the re/insurance markets. On NST accounts there can be involuntary funding caused by market settlement systems or bureaux that debit premiums or additional premiums from an intermediary's NST client account.

There can also be voluntary funding, by which an intermediary pays claims or return premiums from a NST before receipt from a re/insurer. In either case, the intermediary may need to make good a shortfall in the client money account, arising on a client money calculation.

Oversight or errors can lead to inaccuracies in ledgers. For example, not reflecting when a payment or recovery of a bad debt is received, which means the intermediary is not repaid the amount it funded.

There may also be incomplete accounting for settlement transactions, where there are foreign exchange differences, ancillary charges and immaterial settlement differences. Data transfers arising on the amalgamation or acquisition of businesses, and block transfers of balances combined with lost data and records also lead to anomalies.

The first step to removing mistaken entries in a transaction ledger is a proper review of balances and legacy business. It should include consideration as to how balances have arisen. This approach was mentioned in the 2008 Articulation and, in part, in CP12/20.

It's important, too, to gather appropriate supporting evidence for senior management to review. The board (as governing body of the firm/trustee) can then make an informed decision to deal with balances.

Takeaways

So intermediaries should have properly documented and appropriate processes to consider legacy balances carefully on a case by case basis in the context of contracts and trusts. The right accounting and legal advice will help them stand up to scrutiny.

In light of the above, it is questionable whether the regulator ought to stipulate that every CWB is a breach of trust. Generally, the Courts have jurisdiction over trusts constituted in England & Wales and are best placed to deal with potential breaches of trust on a case by case basis. It is also questionable whether it is feasible in the context of NST deeds and intermediaries' ongoing duty to account for monies, to direct intermediaries to pay away monies to a charity or an ARF when that was not addressed in a trust deeds or CASS at the time monies were received.

If you would like to know more about issues raised in this article, please contact Timothy Goodger of Elborne Mitchell LLP.

Timothy Goodger
Partner
Elborne Mitchell LLP

+44 (0)207 320 9178
goodger@elbornes.com

Employee share options: how they trigger tax

Whatever the circumstances of your wish to provide perks to staff, there are tax issues to take into account. We look at the common ways that brokers can provide share incentives and the key tax considerations.

Are you a new broker that wants to reward and incentivise staff from the beginning? Or an established broker aiming to incentivise existing employees to drive further growth? Or perhaps you're looking to bring in a new team and give individuals equity, if certain performance targets are met? Providing share incentives to employees is a great way to encourage them to stay and help develop your business.

But beware. Any transaction in shares that involves a director or employee could create a tax liability for the individual or the employer.

Tax on providing shares or other securities to employees is governed by the employment-related securities rules. These are broad-ranging and can be very complex.

Share award

The most straightforward way in which shares can be provided to employees, an award of shares to an employee, will give rise to a tax liability for the individual to the extent that they are not paying market value for the shares when acquired.

Share options

In their most simple form, share options can be an easy way to provide incentives to employees. They are given an option to acquire a fixed number of shares at a set value in the future, usually on a specific event (such as an exit) or when certain targets such as income or profitability are met.

Where an employee receives a share option there isn't a charge to tax on the grant of the option. But a charge can arise on its exercise. The employee will be subject to Income Tax (unless the shares are an RCA, see below) on the difference between the market value of the shares on exercise and any amount they pay on that exercise.

Enterprise Management Incentives share options

The Enterprise Management Incentives (EMI) scheme is one of the best known tax-advantaged schemes and is widely used by SME brokers. Similar to a standard share option, the scheme works by providing share options to employees, giving them the right to acquire the shares at a set price within 10 years.

EMI differs from standard share options as it allows the business to agree the value of the shares with HMRC on the date the options are granted. If the employee pays an amount at least equal to this agreed valuation on exercise of the options in future, no additional Income Tax is charged to the employee. This means employers can 'lock in' the share price on grant, and any increase in value before exercise won't trigger Income Tax.

But to grant share options under a qualifying EMI scheme, certain conditions must be met. These include some relating to the type of shares they are, whether employees are eligible, and the maximum values that can be granted to an individual and in total. There are also conditions that relate to the business itself, such as its size, independence and what activities it undertakes.

Importantly, while insurance is seen as an excluded activity - therefore preventing these businesses from operating a qualifying EMI scheme - insurance brokers and other insurance intermediaries do not fall within the definition of insurance with HMRC. So brokers can go ahead with an EMI scheme.

Company Share Option Plan

The Company Share Option Plan (CSOP) is another tax-advantaged scheme. Unlike EMI, there's no restriction on the size of the company. So this scheme can be used by larger brokers and other intermediaries or those which might otherwise be excluded from using EMIs.

But the CSOP is more restrictive than EMI as options must be granted at market value, can only be granted over shares worth up to £60,000 per employee and can only be exercised after three years.

Like EMI, on exercise of a qualifying CSOP option, an employee pays the market value of the shares on the date the option was granted. Any increase in value since this date is not subject to Income Tax.

Note that for both the EMI and CSOP schemes, when the shares are sold any increase in value will still be subject to Capital Gains Tax. But these rates are currently significantly lower than the comparative rates of Income Tax.

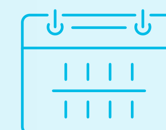
Common issues

Let's look at some of the common challenges faced by brokers providing share incentives. In some cases, for example where the benefits of a qualifying tax-advantaged scheme are lost, this can trigger significantly higher tax liabilities for employees and employers.

Has a valuation been undertaken? – In all cases where share incentives are provided to employees, it's important to calculate the value of the shares. It is this value that's used to determine whether any amount should be subject to Income Tax. In the case of options granted under an EMI or CSOP, it is the value at grant date that counts for determining whether shares acquired under an EMI option are subject to Income Tax - and it must be included as the exercise price in a CSOP qualifying option.

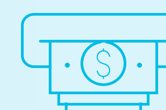
Has the value of shares under an EMI or CSOP option been agreed with HMRC? – HMRC allows for the value of these shares to be agreed in advance of the options being granted. In the case of EMIs this is done by submitting a completed Form VAL231 to HMRC, along with a supporting valuation calculation, or for CSOPs, contacting HMRC Shares and Assets Valuation directly with the valuation.

Have EMI options been notified to HMRC? – The grant of EMI options must be separately notified to HMRC. Otherwise the tax advantages are lost. Up to 6 April 2024 this notification must have been made within 92 days of the option being granted. From this date the notification must be made before 6 July following the end of the tax year in which the grant is made.



Have annual returns been correctly submitted to HMRC? – Where share incentives are provided to employees, it's important to complete and submit an annual return to HMRC detailing the activity. The form is different depending on which scheme is used, but in each case it must be submitted by 6 July following the end of the tax year.

Have the qualifying conditions to tax-advantaged schemes been considered properly? – As mentioned, in the case of both EMI and CSOP schemes there are set conditions for a company to grant qualifying tax-advantaged share options. It's vital for businesses to consider these in detail before awarding the options, to ensure they qualify. If an option granted under an approved scheme turns out not to qualify, from a tax perspective it is treated the same as a standard unapproved option. This can mean significantly higher tax liabilities on exercise.



Are the shares readily convertible assets (RCAs)? – Broadly an RCA is one that, at the time it's received, is capable of being sold or otherwise realised. This includes listed shares. But it's more common in the case of SMEs, because the shares are acquired at the point of a sale or exit event. Where shares are RCAs, any amounts that would usually be subject to Income Tax must now be processed through the payroll and subject to PAYE and NICs (both employee's and employer's).

If you would like further guidance on share option schemes for brokers, please contact Tom Golding.

Tom Golding
Partner

+44 (0)20 7516 2413
tgolding@pkf-l.com

Privacy in check: the control advantage

We explore the benefits of a control-based approach to data protection. How does it contribute to a secure and compliant environment? And what new approaches have recently been approved in the UK?

Insurance brokers are entrusted with a wealth of personal data, a responsibility that cannot be taken lightly. As gatekeepers of sensitive information, they must navigate the complex landscape of regulation with the utmost diligence.

Data is managed in multiple sources: policy administration, claims management and CRM. So a robust data protection strategy is not just an ICO regulatory mandate but a cornerstone of consumer trust and industry integrity.

The EU General Data Protection Regulation (GDPR) significantly raised the stakes following its launch in May 2018, emphasising the need for robust data protection practices. It was adopted as the UK GDPR with minimal tweaks post-Brexit. It brought processors under the law for the first time, extended breach notification obligations beyond telcos and ISPs to all controllers, and introduced large reputational and financial risk from failure to comply.

But the GDPR is a long and complex law. So the lack of a clear, implementable proxy for compliance teams to work against creates challenges for broking firms. Without a real understanding of the processes and procedures needed to meet requirements, brokers can't be confident about achieving and maintaining compliance.

A controls-based approach to the GDPR is developing to address these issues. A controls framework provides management and operational teams with a clear set of requirements that can be measured and tested.

Benefits of a controls-based approach

This approach has long been adopted in the world of security, with well-known standards such as ISO 27001, SOC2 and Cyber Essentials. These provide a structured framework for achieving compliance and the key benefit of visibility and demonstrability of compliance, across firms.

Control testing follows a pre-defined process and results can be summarised to provide robust governance reporting to boards, departments and specialist teams that are responsible for compliance. It offers one common voice for the compliance programme.

Audits play a crucial role in assessing compliance posture. Controls-based frameworks make audits more effective by offering clear documentation of implemented controls. Internal and external auditors can easily check that the necessary safeguards are in place.

Firms can demonstrate their commitment to compliance through well-documented control procedures. This transparency not only satisfies regulatory expectations but also builds trust with stakeholders.

This approach is expanding in the world of privacy, with controls covering aspects such as data access, breach notification, consent management and processing activities management.

The framework landscape

There are many frameworks on the market that address data security, starting with frameworks and benchmarks created by vendors. The high bar is set by ISO27001, with some alternatives that provide easier entry through IASME Assured and Cyber Essentials.

But these are security standards and, while security is fundamental to privacy, it is only one of the GDPR's seven principles. The other six have nothing to do with security.

ISO 27001 does have a separate extension focussed on Privacy: ISO 27701. But this isn't, and is unlikely to become, a formally approved standard for the GDPR. SOC2 can – but does not need to – cover privacy. And, again, SOC2 is not and is unlikely to become a GDPR standard.

These standards can certainly be influential in purchasing decisions and demonstrating overall privacy compliance, and should be part of the decision-making process. But there are benefits of using a certification scheme adopted by data protection authorities under Article 42 of the UK or EU GDPR.

Regulatory recognition

Certification under an approved scheme is highly valued by regulators and brings certain statutory protection and regulatory risk benefits.

The GDPR text refers to the establishment of approved certifications as being "for the purpose of demonstrating compliance" with its obligations, from data protection by design to security and supporting transfers.

Brokers should note that compliance with an approved certification is a factor that regulators must take into account when considering whether to issue a fine and, if applicable, how much that fine should be.

Unapproved standards such as SOC2 and ISO 27701 do not provide these benefits.

ICO-approved certifications

Until recently, the ICO had approved a small number of very niche control frameworks under Article 42 UK GDPR. That changed early this year with the approval of a pan-GDPR framework for the legal industry and their processors relating to the protection of client data: LOCS:23.

While only law firms, other legal services providers, and their processors can be certified under LOCS:23, it is a pan-GDPR standard approved by the UK ICO. This means it provides an influential controls-based standard that can easily be applied by other industries, including financial services.

Indeed, the creator of LOCS:23 has a second standard, currently in the UK ICO's Article 42 approvals process, focussed on the financial services industry, from insurers to consultants, banks to funds. This takes the same approach as, and has identical controls to, LOCS:23. Approval is expected later this year.

Commercial advantages

Beyond regulatory compliance, a controls-based approach offers many significant commercial benefits:

- Competitive edge: Firms certified under recognised schemes signal their commitment to data protection. This can be a differentiator in a competitive market. Clients and partners value firms that prioritise privacy and security.
- Client confidence: Demonstrating compliance through controls reassures clients that their data is in safe hands. Trust is a valuable currency, and compliance efforts contribute to building strong client relationships.
- Risk mitigation: By implementing controls, firms reduce the risk of data breaches and associated penalties. Proactive compliance measures prevent costly legal battles and reputational damage.

So a controls-based approach empowers broking firms to navigate the complexities of data protection compliance effectively. By embracing clear controls, firms not only meet legal requirements but also build a demonstrable culture of privacy and trust. And by adopting a certification approved under Article 42 GDPR, they also gain key regulatory benefits.

To find out more on this topic, please contact Phil Broadbery.

Phil Broadbery
Partner

+44 (0)20 7516 2235
pbroadbery@pkf-l.com

About PKF
Simplifying complexity for our clients

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With over 150 years' experience in the insurance market, PKF has built up a solid and comprehensive reputation as one of a small number of UK accounting firms with in-depth expertise in supporting businesses, their owners and investors across the insurance industry.

Ranked as the largest auditor of insurance intermediaries in the UK and the 7th largest auditor of general insurers, our dedicated insurance team acts for major carriers and syndicates, brokers and MGAs including many businesses harnessing the power of technology to transform the insurance industry.

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£153m
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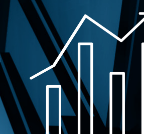

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15
PE backed insurance intermediary clients

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$1.4bn+
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Employees

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Get in touch today to see how we can help...

Paul Goldwin
Partner – Audit & Assurance
+44 (0)20 7516 2251
pgoldwin@pkf-l.com

Phil Broadbery
Partner – Technology
+44 (0)20 7516 2235
pbroadbery@pkf-l.com

Tom Golding
Partner – Tax
+44 (0)20 7516 2413
tgolding@pkf-l.com

John Needham
Partner – Transaction Services
+44 (0)20 7516 2284
jneedham@pkf-l.com

Chris Riley
Partner – Head of Tax
+44 (0)20 7516 2427
criley@pkf-l.com

James Wilkinson
Partner – Audit & Assurance
+44 (0)113 526 6457
jwilkinson@pkf-l.com

Satya Beekarry
Partner – Audit & Assurance
+44 (0)20 7516 2425
sbeekarry@pkf-l.com

Ian Cowan
Partner – Audit & Assurance
+44 (0)20 7516 2281
icowan@pkf-l.com

Will Lanyon
Partner – Transaction Services
+44 (0)20 7516 2411
wlanyon@pkf-l.com

Azhar Rana
Partner – Audit & Assurance
+44 (0)20 7516 2232
arana@pkf-l.com

Martin Watson
Partner – Audit & Assurance
+44 (0)113 524 6220
mwatson@pkf-l.com

Jessica Wills
Partner – Goverance, Risk & Control Assurance
+44 (0)20 7516 2229
jwills@pkf-l.com

PKF

PKF Littlejohn LLP
www.pkf-l.com

London
15 Westferry Circus
Canary Wharf
London E14 4HD
Tel: +44 (0)20 7516 2200

Leeds
3rd Floor, One Park Row,
Leeds, Yorkshire,
LS1 5HN
+44 (0)113 244 5141

Manchester
11 York Street,
Manchester,
M2 2AW
+44 (0)161 552 4220

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